

## Message Text

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C O N F I D E N T I A L ROME 1241

LIMDIS GREENBACK

E.O. 11652: GDS

TAGS: EFIN, IT

SUBJECT: ITALY'S ECONOMIC SITUATION

1. DURING LUNCHEON CONVERSATION WITH ANTONIO FAZIO, HEAD OF RESEARCH DEPARTMENT, BANK OF ITALY, LATTER MADE FOLLOWING POINTS:

2. ECONOMIC OUTLOOK. THE BANK OF ITALY IS PRESENTLY WORKING UNDER THE ASSUMPTION THAT THE 1978 ENLARGED PUBLIC SECTOR DEFICIT WILL BE IN THE 24,000 TO 25,000 BILLION LIRE RANGE (AS COMPARED WITH AN ESTIMATED 20,000 TO 21,000 BILLION LIRE DEFICIT IN 1977). HE SAID THAT THE BANK'S FORECAST SHOWS THAT SUCH A DEFICIT IS CONSISTENT WITH A GROWTH OF ARUND 2.0 PERCENT (A GROWTH LED BY CONSUMPTION AND STOCKBUILDING, PARTICULARLY DURING THE SECOND HALF), WITH A RISE IN THE CONSUMER PRICE INDEX OF AROUND 13 PERCENT (AVERAGE) AND A SURPLUS ON THE CURRENT ACCOUNT ONLY SLIGHTLY BELOW THAT OF 1977. GROWTH IS EXPECTED TO STAGGER ALONG DURING THE FIRST HALF AND TO PICK UP IN THE SECOND HALF OF THE YEAR. THE CURRENT ACCOUNT, ON THE OTHER HAND, IS FORECAST TO REMAIN IN SURPLUS POSITION UP TO THE FALL AND THEN TURN INTO DEFICIT. THE BANK IS EXPECTED TO FOLLOW A MONETARY POLICY WHICH FACILITATES GROWTH DURING THE FIRST PART OF THE YEAR AND WILL TIGHTEN UP IN THE LATTER PART TO CONTAIN POSSIBLE PRESSURES ON THE LIRA. HE ANTICIPATED TOTAL

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PAGE 02 ROME 01241 201755Z

DOMESTIC CREDIT EXPANSION REACHING "CLOSE TO 40,000 BILLION LIRE" IN 1978.

3. INTERVENTION POLICY. FAZIO IS OBVIOUSLY A STRONG BELIEVER OF THE "VICIOUS CIRCLE" ARGUMENT. HIS COUNSEL, HE SAID, IS TO KEEP THE LIRA PEGGED TO THE DOLLAR, EVEN IF AT TIMES THIS MAY HAVE A COST IN TERMS OF OFFICIAL RESERVES. THIS IS ESSENTIAL, HE ARGUED,

TO CONTAIN INFLATION. HE WOULD GO SO FAR AS TO FOLLOW THE DOLLAR UPWARD, SHOULD IT BEGIN STRENGTHENING VIS-A-VIS THE STRONG CURRENCIES DURING THE NEXT FEW MONTHS. THIS IS PARTICULARLY IMPORTANT, HE MAINTAINED, IF THE SHORT-TERM BORROWING OF LAST YEAR, ESPECIALLY THE BUILD-UP IN COMMERCIAL BANK BORROWING, IS NOT TO BE REVERSED. HE NOTED THAT EXPERIENCE INDICATES THAT A WEAKENING OF THE LIRA AGAINST THE DOLLAR TENDS TO TRIGGER EARLY REPAYMENTS OF FOREIGN DOLLAR DEBTS. THE STABILITY OF THE LIRA VIS-A-VIS THE DOLLAR DURING 1977 WAS MAINLY RESPONSIBLE FOR THE SIZEABLE INFLOW OF SHORT-TERM CAPITAL BOTH THROUGH THE COMMERCIAL BANKS AND THROUGH COMMERCIAL CREDITS.

4. ITALY-IMF RELATIONS. ON THIS ISSUE, FAZIO ECHOED THE VIEWS OF OTHER BANK OF ITALY AND TREASURY OFFICIALS PREVIOUSLY EXPRESSED TO US PRIVATELY. THAT IS, ITALY SHOULD SCRAP THE CURRENT STANDBY AND NEGOTIATE A NEW ONE FOR TWO YEARS (1978 AND 1979). HE THOUGHT ITALY WOULD GET BY THIS YEAR WITH DIFFICULTY BUT THAT IN 1979 WOULD COME THE REAL CRUNCH, UNLESS SOME REAL PROGRESS WAS MADE IN REDUCING THE BUDGET DEFICIT. A NEW LETTER OF INTENT, WITH SOME SPECIFIC CONDITIONS ON REDUCING PUBLIC EXPENDITURES, COULD BE VERY USEFUL TO PROGRESS ON THIS FRONT. HE INDICATED A NEED TO GET AT THOSE PUBLIC EXPENDITURES, LIKE PENSIONS, WHICH SEEM TO BE INCREASING AT AN EXPONENTIAL RATE. GARDNER

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## Message Attributes

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